

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to:

Attorney
(Small Business/Self-Employed)

from:

Peter J. Devlin
Chief, Branch 4
(Procedure & Administration)

subject: Levy on LLC for Flow-through Income of Single Member

This Chief Counsel Advice responds to your January 30, 2008 request for assistance.
This advice may not be used or cited as precedent.

LEGEND

X =

LLC =

\$A =

\$B =

\$C =

\$D =

\$E =

\$F =

\$G =

\$H =

\$I =

\$J =

N1 =

N2 =

N3 =

N4 =

Recording
Office =

State A =

State A
Cite 1 =

State A
Cite 2 =

State A
Cite 3 =

State A
Cite 4 =

State A
Cite 5 =

State A
Cite 6 =

State A
Cite 7 =

Case A =

Client 1 =

Vendor 1 =

Vendor 2 =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

D7 =

D8 =

D9 =

D10 =

M1 =

YR1 =

YR2 =

YR3 =

YR4 =

YR6 =

YR9 =

YR11 =

TR13 =

YR14 =

YR15 =

ISSUES

1. Whether a levy served upon a limited liability company will attach to property or rights to property belonging to X, the sole owner of the LLC, who practices law and receives income from the LLC as a result of contingent fee agreements between the LLC and clients?

2. Whether the net profits X receives from the LLC are subject to a continuing wage levy?

CONCLUSIONS

1. Yes.

2. Subject to further factual development, the Service may be able to serve a continuing wage levy upon the LLC to reach payments being made to X if such payments are in the nature of salary or wages.

FACTS

X, the taxpayer in this matter, is an attorney who practices law. X's business (LLC) is organized as a limited liability company under the laws of State A and X is the sole owner. X created the LLC on D1, YR9 pursuant to State A Cite 1. X owes income tax liabilities to the Government in excess of \$A for the YR1, YR2, YR3, YR4, YR6 and YR11 taxable years. The Service filed Notices of Federal Tax Lien (NFTL) in YR4 and YR15 with the Recording Office in connection with these liabilities. The limitation period on collection under I.R.C. § 6502 has expired for some of the earlier liabilities.

The only potential asset the Service has identified as available to satisfy X's liabilities is the income paid to him by the LLC generated by the LLC's sporadic stream of accounts receivable from personal injury contingent fee agreements. You forwarded to our office a blank copy of an "Attorney/Client Contingent Fee Agreement", which X uses in his law practice. The contingent fee agreements are between the LLC and the clients who need legal services. A client agrees to pay the LLC immediately upon completion of his case 33% of the total gross recovery realized by settlement, or if the case does not settle within three weeks before trial, 40%. The contingent fee agreements do not generate receipts with any pattern of regularity. Rather, money flows into the LLC when X is successful in a lawsuit. X wins a few cases per year and his law practice grosses approximately \$B annually, which is deposited in the LLC's bank account.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

X reports his income for federal income tax purposes as net profits from the operation of a business (Schedule C) and he also incurs self-employment tax. For the YR14 taxable year, X's Form 1040 showed gross receipts from his law practice totaling \$C (schedule

C) and taxable business income in the amount of \$D. For YR 13, X reported \$E as gross receipts and \$F as taxable business income.

The Service's Collection function has requested assistance in regard to the most effective way to collect the outstanding tax liability of X. X has refused to cooperate with Collections and will not agree to satisfy the tax liabilities voluntarily through an installment agreement or otherwise.

[REDACTED]

You correctly observed that absent an alter-ego relationship, the Service may not levy upon the LLC's assets to satisfy the single-owner's debts.

Seizing X's interest in the LLC is not viable, in your opinion, because there are no other owners who would be interested in purchasing it.

You are considering undertaking the following steps:

[REDACTED]

[REDACTED]

LAW AND ANALYSIS

1. *Does LLC hold property or rights to property of X subject to levy?*

The Code provides two methods by which the Service can enforce the lien created by I.R.C. § 6321. It can bring a foreclosure action pursuant to I.R.C. § 7403 or it can levy on the taxpayer's property pursuant to I.R.C. § 6331. United States v. Hemmen, 51 F.3d 883 (9th Cir. 1995). Unlike a foreclosure action, the levy is a provisional, administrative procedure, National Bank of Commerce, 472 U.S. at 722, 105 S.Ct. at 2924, and it reaches only "property possessed and obligations existing at the time of the

levy.” Hemmen, 51 F.3d at 887 (*quoting* I.R.C. § 6331(b)). Treasury Reg. § 301.6331-1(a)(1) interprets this “present obligation” requirement as follows:

. . . Levy may be made by serving a notice of levy on any person in possession of, or obligated with respect to, property or rights to property subject to levy . . . Except as provided in § 301.6331-1(b)(1) with regard to a levy on salary or wages, *a levy extends only to property possessed and obligations which exist at the time of levy. Obligations exist when the liability of the obligor is fixed and determinable although the right to receive payment thereof may be deferred until a later date* . . . (emphasis added).

As a threshold matter, therefore, we must determine whether X’s right to receive income from the LLC is “property” or a “right to property” under State A law. Hemmen, 51 F.3d at 886; see also Drye v. United States, 528 U.S. 49, 52, 120 S.Ct. 474, 478 (1999) (two-part test for determining taxpayer’s property and rights to property under I.R.C.). Under Title 1 of the State A Statutes, “property” is defined to include real and personal property.¹ State A Cite 3 provides: “personal property” includes money, goods, chattels, things in action, and evidences of debt. See e.g. Case A (debtor’s vested interest in employer-sponsored 401(k) savings plan constitutes property under State A Cite 3).

Most relevant to this matter, State A Cite 4 creates a statutory right in the member of a limited liability company to be repaid his capital contribution and to share equally in the limited liability company’s profits². This states:

. . . **Repayment of contributions and sharing of profits and other assets.** Subject to State Cite 5 – State Cite 6, and unless otherwise provided in an operating agreement of the company, *a member of a limited liability company* shall be repaid the member’s contribution to capital and *shares equally in the profits* and other assets of the company remaining after all liabilities, including liabilities to members, are satisfied. (emphasis added).

In our view, the right to the return of one’s capital contribution to a limited liability company and to share in the limited liability company’s profits is a property right under State A law. *Cf.* Case A.

Next, we must consider whether, as a matter of federal law, a notice of levy served on the LLC will obligate it to turn over the income to which X is entitled to receive as a consequence of rendering legal services. Hemmen, *supra*. As noted above, in order for the LLC to be obligated to turn over property or monies to the Service, it must be in possession of X’s property or be obligated to X at the time of levy. Treas. Reg. § 301.6331-1(a)(1); Beam v. Internal Revenue Service, 1999 U.S.App. Lexis 25605 (9th Cir. 1999). Courts hold that the “fixed and determinable” requirement in Treas. Reg.

¹ State A Cite 2.

² The limited liability company’s operating agreement can provide otherwise with regard to distributions.

§ 301.6331-1(a)(1) is satisfied when the events which give rise to the obligation have occurred and the amount of the obligation is capable of being determined in the future. Hemmen, 51 F.3d at 890; CPS Electric, Ltd v. United States, 200 F.Supp.2d 120, 125 (N.D.N.Y. 2002) (cause of action in context of personal injury lawsuit, not its undetermined proceeds, was a property interest to which levy attached); United States v. Antonio, 1991 U.S. Dist. Lexis 14129 (D. Haw. 1991)(obligation on contract was fixed when performance occurred); Simon v. Playboy Elsinore Associates, 1991 U.S. Dist. Lexis 5729 (E.D. Pa. 1991)(unliquidated personal injury claim was a property right against which federal tax lien could be asserted, and levy attached to this even though served prior to settlement of lawsuit).

In Tull v. United States, 69 F.3d 394 (9th Cir. 1995), the Service was unsuccessful in a case discussing “fixed and determinable” as those terms are set forth in Treas. Reg. § 301.6331-1(a). There, the Ninth Circuit Court of Appeals held that an auctioneer did not have a fixed and determinable obligation to the taxpayer even though there was a signed auction contract. The court reasoned that even though the auctioneer had an obligation to attempt to sell the property, the fact that both the buyer and price were undetermined, the obligation was “unfixed and undetermined.” 69 F.3d at 397.

In another Ninth Circuit case involving this issue, however, the Service prevailed. Hemmen, *supra*. There the Service assessed a civil tax penalty totaling \$70,132.89 against the taxpayer.³ The bankruptcy court entered an order allowing an administrative expense totaling \$18,000 to the taxpayer for his aid in preserving the estate of the corporate debtor-in-possession. The Hemmen court ruled in favor of the Service, reasoning that the trustee’s liability to pay the administrative expense claim was fixed and determinable because the taxpayer fully performed the beneficial acts which gave rise to his claim, and such claim was allowed by the court prior to the service of the notice of levy. 51 F.3d at 890. The court stated, “[u]nlike a requirement that the extent of an obligation be “determined,” the term “determinable” requires only that the sum be capable of precise measurement in the future.” *Id*; see also CPS Electric, *supra*; Simon, *supra*.

In this case the Service can serve a notice of levy upon the LLC to require it to turn over to the Service income in the LLC’s possession to which X is entitled as a result of legal services rendered prior to the service of the notice of levy.⁴ Under the rationale of Hemmen, Antonio, CPS Electric and other cases, the LLC’s obligation to X is “fixed and determinable” when the LLC receives a contingent fee sum following successful litigation and after setting aside a reserve for overhead expenses.⁵

³ The taxpayer, an individual, was the president of a corporation which filed a bankruptcy petition.

⁴

[REDACTED]

The Service does not take the position that future payments which may be made under an existing contingent fee agreement are fixed and determinable as to X because the contingent fee agreement is between the LLC and the client, not between X and the client. State A Cite 7 supports this and provides, "Property transferred to or otherwise acquired by a limited liability company is the property of the company and is not the property of the members individually." Under this provision and the courts' interpretation of Treas. Reg. § 6331-1(a)(1), the LLC, not X, holds the right to be paid from successful lawsuits or settlements under the contingent fee contracts. CPS Electric, supra; Drye, 528 U.S. at 58, 120 S.Ct. at 475 (court looks initially to state law to determine what rights the taxpayer has in the property the Government seeks to reach); Cf. Adler v. Nichols, 166 F.2d 674, 678 (10th Cir. 1948)(partnership checking account in bank not subject to distraint to satisfy liability assessed against individual partner).

Although the Service can serve a Notice of Levy (Form 668-A) upon the LLC to seize the property belonging to X or obligations owed to X under the above discussion, the Service may, upon conducting further factual development, be able to serve a Notice of Levy on Wages, Salary, and Other Income (Form 668-W) based on the below discussion.

2. Whether the net profits paid to X by the LLC are subject to a continuing wage levy?

As noted above, generally, a levy extends only to property possessed and an obligation existing at the time levy is made. As an exception to this general rule, I.R.C. § 6331(e) authorizes a continuing levy upon salary or wages. Meehan v. Commissioner, 122 T.C. 396, 400 (2004). Section 6331(e) provides:

(e) Continuing levy on salary and wages

The effect of a levy on salary or wages payable to or received by a taxpayer shall be continuous from the date such levy is first made until such levy is released under section 6343.⁶

⁵ If X abandons a client or otherwise does not provide legal services under a contingent fee agreement, the LLC will hold no net profits attributable to the particular agreement to which a levy could attach.

⁶ The regulation interpreting this provision describes the types of payments covered by this Code section as follows:

(1) *Continuing effect of levy on salary and wages.-*

. . . For this purpose, the term *salary or wages* includes compensation for services paid in the form of fees, commissions, bonuses, and similar items. The levy attaches to both salary or wages earned but not yet paid at the time of levy, advances on salary or wages made subsequent to the date of levy, and salary or wages earned and becoming payable subsequent to the date of the levy . . . In general, salaries or wages that are the subject of a continuing levy . . . are to be paid to the district director . . . on the same date the payor would otherwise pay over the money to the taxpayer . . .

Section 6331(e) does not specify the types of remuneration that are covered by the terms “salary or wages.” Meehan, 122 T.C. at 401. The courts have construed these to include a variety of types of payments. Sims v. United States, 359 U.S. 108, 79 S.Ct. 641 (1959)(compensation due to state and municipal employees); Meehan, 122 T.C. at 403-04 (severance pay paid by an employer to its former employee); In Re Anderson, 250 B.R. 707 (Bkrtcy. D. Mont. 2000)(social security payments); Maloney v. Syvertsen, 85-2 U.S.T.C. P9,578 (S.D.N.Y. 1985)(future wages and fees).

In U.S. v. Jefferson-Pilot Life Ins. Co., 49 F.3d 1020 (4th Cir. 1995), the Fourth Circuit Court of Appeals held that I.R.C. § 6331(e)’s continuing levy provision applied to commissions payable to an independent contractor insurance salesman. Jefferson-Pilot involved the Government’s action to enforce a levy against an insurance company (“defendant”), which paid the commissions. The defendant argued that the Service only had the authority to serve it with a one-time levy because it- the defendant- was not the taxpayer’s employer.

The court in Jefferson- Pilot ruled for the Service, holding that: 1) the words “salary or wages payable to or received by a taxpayer “ in Code section 6331(e) are not so restrictive as to exclude the possibility that Congress intended them to apply to a commission paid to an independent contractor; 2) the underlying purpose of I.R.C. § 6331(e) is to provide a means of levying upon the remuneration payable to a taxpayer on a recurring basis for personal services for the payor; 3) the legislative history indicated that Congress created the continuing levy provision in order to ease the substantial administrative problems the Service would face if it could only impose successive levies upon remuneration contractually owed to a delinquent taxpayer for personal services. Jefferson Pilot, 49 F.3d at 1022-23; see *also* United States v. MPM Financial Group, Inc., 2005-2 U.S.T.C. P50,650 (E.D. Ky. 2005)(S corporation improperly failed to honor levy in connection with president’s proportionate share of income from commissions).

More recently, a district court held that the amounts paid and payable to a member of a law firm, organized as a partnership, were subject to a continuing levy. United States v. Moskowitz, Passman & Edelman, 2007 U.S. Dist. Lexis 75407 (S.D.N.Y. 2007). In Moskowitz, the delinquent taxpayer, an attorney, was a partner in a law firm. There, evidence developed through the deposition of the partner who handled the books of the firm showed that: 1) he wrote himself and his junior partner checks from whatever was available in the law firm’s bank accounts; 2) he wrote the checks on a weekly basis; 3) the checks were intended as rough advances to each partner against the total income and firm profits they were due to receive in a given year; and 4) the payments were principally motivated by one of the partner’s “continuing needs”.

Between 1996 and 1997 the Service served on the law firm two levies, Form 668-W(c) and Form 668-A(c)) and two Final Demand Letters (Form 668(c)). The 1996 levy stated that it applied to “(1) This taxpayer’s wages and salary that have been earned but not paid yet, as well as wages and salary earned in the future until this levy is released, and (2) this taxpayer’s other income that you have now or for which you are obligated.” 2007 U.S. Dist. Lexis 75407, at 1-2. The law firm honored neither levy. The law firm argued that the checks drawn against the partnership’s bank account were not subject to the levies served on the firm because they were a “draw or an advance or a loan against what is ultimately converted to income at the end of the year.” *Id.* at 5.

Relying on Jefferson-Pilot and United States v. Has, Inc., 1990 U.S. Dist Lexis 2473 (D. Puerto Rico 1990), the Moskowitz court rejected this contention, stating “. . . [h]owever, calling it a draw or an advance instead of income or salary is insufficient to except it from the levies’ ambit.” 2007 U.S. Dist Lexis 75407, at 5. In support of its holding, the court also stated, “. . . [k]eeping in mind the spirit of the law, the fact that monies are paid out to the partners frequently [sic] weekly as advances on future income cannot exempt the law firm from the statute by virtue of . . . [the taxpayer’s] partner status.” *Id.* at 5-6. Accordingly, the periodic draws from the partnership paid to the partner constituted income or salary subject to the continuing levy. *Id.* at 6.

Based on Jefferson-Pilot and Moskowitz, the payments X receives from the LLC as his net profits *may* be subject to the continuing wage levy provision of I.R.C. § 6331(e). As discussed below, the Service will have to develop more facts before making this conclusion.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Given the district court’s holding in Moskowitz, *supra*, there is a possibility that the Service can characterize the profits X receives from the LLC as income subject to a continuing wage or salary levy under I.R.C. § 6331(e). The Service must obtain additional information in this matter because in Moskowitz and Jefferson-Pilot, each court based its decision on the fact that the remuneration was paid out to the delinquent taxpayer on a recurring basis. [REDACTED]

[REDACTED]

[REDACTED]



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Please call (202) 622-3630 if you have any further questions.